A NEW TANGLE IN BANKRUPTCY LAW.

Equity will remove what obstructs a legal right. The proposition that a general creditor must get judgment before attacking a fraudulent conveyance, has no connection with the proposition that, except in cases like the ancient landlord's distress, a creditor has no "rights" as to his debtor's property until he gets personal judgment or some statutory substitute for outlawry. He merely has a right *to get* the right to subject it.

A man may transfer to another man a right which he himself owns, but he cannot transfer a right which is owned by his creditor. Nemo dat. But statute often transfers to the assignee of an insolvent the rights which belong to the insolvent's creditors. Judicial legislation has enacted that such an assignee may exercise a "power" which a general creditor cannot: to wit, he may attack a fraudulent conveyance although not representing a creditor who has judgment. In other words. the creditor's right *to get* the right to attack is converted into a present subsisting right. Different theories are offered to warrant this judicial legislation, but none satisfactory, unless it be that it was "necessity." (1)*

Section 70a (4), of the Bankruptcy Act, says that the trustee "shall be vested with the bankrupt's title to all property transferred by him in fraud of his creditors." It is assumed that the Supreme Court will echo opinions like Re Wynne, 4 B. R., and hold that Congress meant to say that the trustee, subrogated to the rights of creditors, may file his bill though no creditor has judgment. (2)

Confusion exists because many nisi prius federal opinions did not distinguish decisions based on the fact that the deed, then before the court, was void under state law as to general creditors, from decisions based on the fact that the deed, then before the court, was not void as to general creditors. If the grantor intended to hinder, and the grantee had notice, the deed is void as to general creditors, but they cannot meddle unless they invoke judicial machinery. Eliz. aimed at the grantor's corrupt intent: recording acts aim at the grantee's negligence. In some states failure to record makes the deed void as to general

*These figures in parentheses refer to an Appendix which will be in the next issue of the REGISTER.

creditors whereas, in other states, it is not void until creditors get some lien.*

Until York Mfg. Co. *v.* Cassell (1906), 201 U. S. 344, 50 L. Ed. 782, nisi prius courts supposed that bankruptcy gave creditors a lien. York had sold a machine to Ice but reserved title This reservation of title was not recorded and Ohio law said that it was valid unless a creditor got judgment. A year later Ice bankrupted and no creditor had judgment: hence the reservation of title was valid at the time that bankruptcy picked the estate up and York was entitled to his machine.

Observe the radical and vital difference between the *character* of the right† which a general creditor has when a deed is void under 13 Eliz. and the character of his right when an unrecorded deed is not void unless and until he gets judgment. When void under 13 Eliz. he only needs *to get* the right to attack, and he gets this right by getting judgment. Getting judgment does make it void; it is already void as to a general creditor. (3) But, if the deed is not void until the creditor gets judgment, then getting judgment makes void that which is now valid. Making it void creates a new right: to wit, a right which did not exist so long as the deed was valid. (4)

The right *to get* a right to attack a deed which is already void, is one thing; the right to take such action as will make void what is now valid, is another thing. So long as it was valid the creditor did not have the right *to get* the right to attack.

Observe, getting judgment has a two-fold effect: it both makes void and also creates the right to attack. This double barrel effect confuses unanalytic minds. To a layman water is a fluid; to a chemist it is hydrogen mixed with oxygen.

If a man dies after making a deed which is void as to his general creditors, they can reach the property. Death does not destroy the right to get the right to attack. But if it is not void as to general creditors and none have judgment, then his creditors

*"Lien." Whenever the law gives a creditor the right to have a debt satisfied from the proceeds of property, or before the property can be otherwise disposed of, it gives a "lien." Re Wynne, 4 B. R. See "Words and Phrases" as to the vagueness of this word.

†"Rights." A legal consequence which attaches to certain facts. White *v.* Miltimale, 13 Or., 10 Pac., quoting Prof. Holmes' Lectures.

cannot reach the property. Death does destroy the right to make a deed void by getting judgment. (5) It seems that no court or text-writer has "sorted out" such opinions as deal with this point and were well considered.

When death picks up an insolvent's estate, his administrator takes whatever the insolvent, if living, could claim, but, in the absence of statute, he does not take rights which belonged to the insolvent's creditors and not to him. Death destroys capacity to acquire such rights as can only be created by obtaining personal judgment.

Before the act of 1898 a bankrupt's trustee could not make claim, as to ante four months matter, except when claiming as successor to creditors respecting a conveyance which was void under 13 Eliz., or when claiming as successor to the bankrupt himself. The act of 1867 did not give the trustee the rights of creditors except as to conveyances void under 13 Eliz. (6) But the present law intends that the trustee may attack any deed which any creditor could have attacked, under state law, when the four months commenced to run.

It is assumed that, if attention is sufficiently arrested, the Supreme Court will make emphatic utterance:

One, that Congress did not intend to destroy any "right" which had vested under State law prior to the four months.

Two, that, if a conveyance was void as to a general creditor, then the right, *to get* the right to attack was a vested right.

Three, that, if a conveyance was not void except as to judgment creditors then the right, to make it void by getting judgment, was not a vested right, and, if bankruptcy picked the estate up before the conveyance had been made void, then the trustee cannot make claim to the property involved. (Possibly, this is not strictly accurate if the suit commenced after the amendment in 1910.)

While writing the provisions about collecting up the "estate in bankruptcy" (to wit, what the trustee may claim as successor to the bankrupt, *plus* what he may claim as successor to the rights of creditors), Congress was not thinking about the provisions enacting how the assets, when converted into money, should be distributed. When Congress came to consider distribution it had three separate objects, or intentions, in view: One, not to upset any "right" which had vested under State law prior to the four

months; two, to secure equality commencing four months before the petition was filed; and three, to secure equality among creditors whose rights were the same when the four months commenced to run. (Be it remembered that this paper is restricted to ante four months matter.)

The cases which have thus far come before the Supreme Court only involved either questions relating to collecting up the estate or else questions relating to four months matter. It seems that, thus far, the Supreme Court has not had occasion to interpret § 64 b (5): "The debts to have priority, except as herein provided, * * * and the order of payment shall be, expenses, taxes * * * debts owing any person who, *by the laws of the States* or of the United States is entitled to priority."

As stated above it had been long settled in most of the States that, if an unrecorded deed was void as to general creditors, then the statutory assignee of an insolvent could attack it although not representing a creditor who had judgment. (7) Next came the question whether a bankrupt's trustee could attack a deed which was not void unless creditors had got judgment, and nisi prius courts held that he could. This holding was grounded on the theory that bankruptcy gave a lien. York Mfg. Co. *v.* Cassell upset this theory. But such cases are manifestly irrelevant when an unrecorded deed is void as to general creditors.

Ruggles *v.* Cannedy (1898), 127 Cal. 290, 53 Pac. 911, 46 L. R. A. 371 (dissenting opinion 59 Pac. 827) calls attention to the fact that recording acts are so different and local interpretation of exactly the same language is so different in one State from what it is in another State that it is unsafe to quote either text-writers or decisions unless the decision comes with an opinion by an analytic mind taking trouble to exhibit the "protoplast" of his propositions. Some illustrations may be useful.

I. A statute, as locally interpreted, said: "An unrecorded mortgage shall be void as to the mortgagor's general creditors." Being void as to general creditors they have the right to get the right to attack it; viz, they may get judgment and then levy, and the bankrupt's trustee, being subrogated to this right, may attack it though no creditor has judgment.

It seems that, after such a mortgage has been avoided, the right

of pre-existing creditors, including the mortgagee, are the same as they would be if no mortgage had been attempted. And this seems reasonable. The mort gee's negligence has forfeited his security and all creditors should prorate. They could do so, if no mortgage.

II. The statute of another State, as locally interpreted, said: "A mortgage shall be void as to creditors who get judgment before it is recorded." At this point the confusion calls for a Justinian to enact which opinions may be quoted and making it a felony to mention any others. This confusion exists because many courts did not distinguish between a deed which was void as to general creditors and a deed which was not void except as to creditors who had got judgment.

III. The statute of another State, as locally interpreted, means as if written: "An unrecorded deed is void only as to such of the mortgagor's general creditors as gave him credit after the mortgage but before it was recorded."

Here then are two distinct classes of creditors. It was valid as to one class. If no bankruptcy they could get judgment but could never touch this property. The other class could get judgment and then levy.

It is assumed that the Supreme Court will, if attention be sufficiently arrested, make emphatic utterance:

I. That the trustee may attack a deed which is void as to general creditors, and could do so before the Amendment of 1910.

II. That, if it be an ante four months matter and is void only as one class, then the recovery must be prorated among that class. (8) It is inconceivable that Congress intended to create rights which are unknown to the laws of any State. It is inconceivable that Congress intended that, when only one creditor has rights respecting an ante four months conveyance and the trustee brings suit solely in his right, then the recovery shall go to a different person who had no rights and, if no bankruptcy, could never get any. Cases like First National Bank *v.* Staake, 202 U. S. 141, 50 L. Ed. 967, have no possible bearing. Congress *did* intend that, when several creditors had the same right, quoad an ante four months matter, and one got a lien, within the four months, then

he must divide with any one who had the same rights when the four months commenced. Congress was trying to prevent the scramble which is likely when insolvency is suspected. This scramble does not come when an insolvent gets sick because creditors discount death. In Staake's case the deed was void as to any creditor who attacked before it was recorded. It seems safe to assume that the decision would have been very different if it had been void only as to one class.

Two recent decisions seem to sufficiently illustrate what will be the value of a well-considered opinion by the Supreme Court interpreting § 64b(5).

In Martin, 193 Fed. 841 (C. C. A. Ky. Feb. 1912) a Kentucky statute, as locally administered, says: "A gift shall be void *only* as to the pre-existing general creditors of the grantor." Atkins owed the bank and, while owing this one debt, he conveyed a farm to his son as a gift. Subsequently he incurred debts to X, Y and Z. Several years after this gift the bank attached the farm and brought suit to subject it to his debt. Thereupon Atkins filed his petition in bankruptcy. The trustee took charge of the suit and "preserved the attachment lien." The trustee also brought another suit in behalf of the subsequent creditors The State court decided that the gift was valid except as to bank's pre-existing debt and dismissed the suit as to subsequent creditors. The State court then sold the farm and sent the proceeds to the bankruptcy court. The C. C. A. held: Although, under State law, the proceeds must go to the pre-existing creditor yet, under the Bankrupt Act, the fund must be prorated with subsequent creditors. The court reasoned thus: "The statute said the conveyance was void as to the bank, but this did not give him any *lien*. It only gave the right to get a lien. He had no lien until he attached and, as this attachment lien was acquired within the four months, it passed to the trustee as part of the bankrupt's estate." Observe, it was a conveyance two years before bankruptcy and, except for bankruptcy, subsequent creditors could not possibly have got any right as to this gift.

The case In Huxoll, 193 Fed. 851 (C. C. A. Mich.), was before the same court and at the same term. In Michigan an unrecorded chattel mortgage is void only as to the subsequent general creditors of the mortgagor and, in any proceedings in

the State court, subsequent creditors must be paid to the exclusion of pre-existing creditors.

Merchant gave a mortgage to Huxoll, who did not record it for a year and during the year incurred subsequent debts. When Huxoll recorded, Merchant bankrupted and delivered the mortgaged property to his trustee; thereupon Huxoll asked to prorate as an unsecured pre-existing creditor. The court said:

"The question is, whether the superior rights of subsequent creditors, as given to them by State law, amount to a priority under § 64b(5), or (in the absence of proceedings to fasten a lien on the property) whether such superior rights amount only to a right to fasten such a lien. We think this statute is not within the purview of § 64b (5). If these superior rights amount to a mere right to fasten a lien, as distinguished from an actually established lien, then they could not be given effect under the bankrupt act because bankruptcy does not operate as an attachment. York *v.* Cassell, supra."

Observe, the mortgage being valid between parties the trustee could not claim as successor to Merchant; he must claim exclusively as successor to the rights of creditors as to whom it was void. It was void only as to subsequent general creditors; and they alone had the right *to get* the right to attack it. In York *v.* Cassell and Crucible Steel Co. *v.* Holt, 224 U. S. 262, 56 L. Ed. 756, 32 S. Ct. 414, the deed was not void as to *general* creditors.

In re Economical (1901), 110 Fed. ——, was grounded on the naked proposition that, as to ante four months matter, a fund collected in the exclusive right of A must not be given to Z. These opinions in 193 Fed. are grounded on the proposition of equality among all proving debts unless a lien (in the sense of having an execution) has been acquired prior to the four months, nd § 64b (5) is restricted to priorities given by state insolvency laws. Judge Knappen in In re Jones, 151 Fed. 108; Remington on Bankruptcy, § 2196.

In re Hurst, 188 Fed. 707, and 194 Fed. 830, is another illustration. Son owed Parent $10,000 borrowed money. Several years later Son, being insolvent, conveyed his farm to Parent with intent to hinder creditors and Parent had notice of said intent. Five years after this conveyance Son bankrupted and

surrendered to his trustee $1,000 of personalty. Creditors proved $30,000 of debts and Parent proved his $10,000 borrowed money debt. The trustee brought suit against Parent to recover the farm and it sold for $5,000. It was fraud in fact but Parent claimed to prorate because his debt had no connection with the conveyance. The referee held that he could prorate in the personal property but not in the farm, and quoted Justice Bradley in Milwaukee, etc., R. Co. *v.* Soutter, 13 Wall. 517, 20 L. Ed. 543: "Was it ever known that a fraud-in-fact grantee could recover for repairs when the property was taken from him?" It seems both district and circuit courts considered that the fund must be prorated among who proved debts, including the fraud-in-fact grantee, although he could not share under the laws in any state. (9).

Will not Congress repeal the Bankrupt Act unless the Supreme Court promptly so interprets § 64b (5) as to remedy this surprising situation?

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